LIBRARY
SUPREME COURT, U.S.

Office - Supreme Court, U.S.
FILED
SEP 27 1956
JOHN T. FEY, Clerk

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1956.

No. 64.

LIBSON SHOPS, INC.,
Petitioner,

v.

GUSTAVE F. KOEHLER, District Director
of Internal Revenue.

On Writ of Certiorari to the United States Court
of Appeals for the Eighth Circuit.

PETITIONER'S BRIEF ON THE MERITS.

ABRAHAM LOWENHAUPT,
HENRY C. LOWENHAUPT,
OWEN T. ARMSTRONG,
408 Olive Street,
St. Louis 2, Missouri,
Counsel for Petitioner.

Of Counsel:
LOWENHAUPT, MATTINGLY, CHASNOFF,
FREEMAN & HOLLAND.

INDEX.

	Page
Opinions below	1
Jurisdiction	1
Statutes Involved	2
Question Presented	2
Statement of the Case	2
Summary of Argument	6
Argument:	
I. The Problem in its Legislative Setting	8
A. The Statutes Involved	8
1. Petitioner includes each of the merged corporations.	
2. Petitioner through the merger achieved the tax status of each of the merged corporations.	
B. Related Legislation	16
II. The Problem before the Treasury and in the Courts	19
A. The Government's Position in Cases of Statutory Merger	19
B. The Recent Cases	25
III. The Court of Appeals' Opinion	27
Conclusion	35
Appendix:	
(i) Statutes Involved	37
(ii) Historical Note	39
(iii) State Statutes Governing Merger	40

TABLE OF CITATIONS.

Cases:

Adrian & James, Inc., 4 T. C. 708 (1945) 16
Alaska Salmon Co., 39 B. T. A. 455 (1939) 15
Alprosa Watch Corporation, 11 T. C. 240 (1948) 33
Argenbright v. Phoenix Finance Co. of Iowa, 21 Del. Ch. 288, 187 A. 124 (1936) 11
Aspinook Corp. v. Commissioner, 326 Mass. 327, 94 N. E. (2d) 366 (1950) 11
Athol Mfg. Co. v. Commissioner, 54 F. (2d) 230 (1st Cir., 1931) 32
Bazley v. Commissioner, 331 U. S. 737 (1947) 13
Bowman Hotel Corporation, 24 B. T. A. 1193 (1931) .. 15
California Casket Co., 19 T. C. 32 (1952) 20
Dodier Realty and Investment Co. v. St. Louis National Baseball Club, 238 S. W. (2d) 321 (Mo., 1951) 11
E. & J. Gallo Winery v. Commissioner, 12 T. C. M. 414, rev'd 227 F. (2d) 699 (9th Cir., 1955) 7, 9, 18, 20, 24, 25, 27, 32
Griffiths v. Commissioner, 308 U. S. 355 (1939) 13
Helvering v. Metropolitan Edison Co., 306 U. S. 522 (1939) 6, 12, 22, 23, 29, 31, 32
Koppers Coal Co., 6 T. C. 1209 (1946) 16
Koppers Company, Inc., v. United States, 134 F. Supp. 290 (Ct. of Claims, 1955) .. 6, 7, 15, 16, 18, 20, 23, 25, 26, 27
Lewyt Corp. v. Com., 349 U. S. 237 (1955) 28
Moldit, Inc., v. Jarecki, 53-2 U. S. T. C. ¶ 9551 (D. C. Ill., N. D., 1953), appeal dis'd pursuant to stip. (7th Cir., July 26, 1954) 21
Morrisdale Coal Mining Co., 19 T. C. 208 (1952) 23
Mutual Building and Loan Association of Pasadena v. Wiborg, 59 Cal. App. (2d) 325, 139 P. (2d) 73 (1943) 12
New Colonial Ice Co. v. Helvering, 292 U. S. 435 (1934) 7, 20, 21, 22, 23, 28, 30, 33

Newmarket Mfg. Co. v. United States, 233 F. (2d) 493 (1st. Cir., 1956) 7, 9, 21, 25, 26, 27, 31
Northway Securities Co., 23 B. T. A. 532 (1931) 33
Oswego Falls Corporation, 26 B. T. A. 60 (1932), aff'd 71 F. (2d) 673 (2d Cir., 1934) 14
Phillips v. Howe Films Co., 33 F. (2d) 891 (3d Cir., 1939) 16
Reo Motors v. Commissioner, 338 U. S. 442 (1950) ... 8
A. D. Saenger, 38 B. T. A. 1295 (1938) 14
Standard Paving Co. v. Commissioner, 13 T. C. 425 ..21, 23
Stanton Brewery, Inc., v. Commissioner, 11 T. C. 310 (1948), rev'd 176 F. (2d) 573 (2d Cir., 1949) 6, 7, 11, 15, 18, 19, 20, 21, 23, 24, 25, 26, 30, 32, 33
Trahern Pump Company, 27 B. T. A. 363 (1932) 15
Turner-Farber-Love Co. v. Helvering, 68 F. (2d) 416 (D. C. Cir., 1933) 32
U. S. v. Seattle-First National Bank, 321 U. S. 583 (1944) 29

Statutes:

Act of July 15, 1947, c. 249, 61 Stat. 324 17
California Civil Code (1943), § 361 12
Delaware General Corporation Law, § 60 (Delaware Code of 1953, § 259) 11
Illinois Business Corporation Act, Laws 1933, p. 310 (Ill. R. S., c. 32, § 157):
Sec. 61 10
Sec. 67 10
Sec. 69 10
Sec. 69 (a), (b), (d) 10
Sec. 69 (e) 14
Internal Revenue Code of 1939:
Sec. 23 (s) 2, 8, 9
Sec. 112 (b) 21
Sec. 122 .....2, 6, 8, 9, 26, 27, 33
Sec. 122 (b) (2) (C) 9, 14, 20, 26

Sec. 129 33
Sec. 272 (a) (1) 15
Sec. 710 (c) (3) (B) 20, 25, 26
Sec. 742 ..... 20, 25
Sec. 3797 (a) (14) 9
Internal Revenue Code of 1954, § 381 ..... 6, 18
Missouri General and Business Corporation Act, Laws 1943, p. 410 (Mo. R. S. 1949, c. 351):
Sec. 62 10
Sec. 68 10
Sec. 70 10
Sec. 70 (e) 14
Revenue Act of 1918, § 204 (b), c. 18, 40 Stat. 1057 .. 13, 28

Miscellaneous:

Brief for the Respondent in Opposition, Standard Paving Co. v. Commissioner, cert. den., 342 U. S. 80 (1951) 21
Brief for the United States, filed April 29, 1955, Koppers Company, Inc., v. United States, 134 F. Supp. 290 (Ct. of Claims 1955) 23
Fletcher, Cyc. Corp. (Perm. ed.), § 7041 11
Griswold, Note, 56 Harv. L. Rev. 1142 (1943) 28
H. R. Rep. No. 871, 78th Cong., 1st Sess. 33
H. R. Rep. No. 624, 80th Cong., 1st Sess. 17
H. R. Rep. No. 1337, 80th Cong., 2d Sess. 18, 19
Mim. 5957, 1945 Cum. Bull. 181 21
P. S. No. 62, 1950 CCH Standard Fed. Tax Rep. par. 6118, Petition for certiorari, filed June 28, 1956, U. S. v. Newmarket Mfg. Co., No. 216, October Term, 1956 7
S. Rep. No. 617, 65th Cong., 3d Sess. 6, 13
S. Rep. No. 627, 78th Cong., 1st Sess. 33
S. Rep. No. 1622, 83d Cong., 2d Sess. 18, 19

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1956.

No. 64.

LIBSON SHOPS, INC.,
Petitioner,

v.

GUSTAVE F. KOEHLER, District Director
of Internal Revenue.

On Writ of Certiorari to the United States Court
of Appeals for the Eighth Circuit.

PETITIONER'S BRIEF ON THE MERITS.

OPINIONS BELOW.

The opinion of the District Court (R. 32) is reported at 55-1 U. S. T. C., paragraph 9458. The opinion of the Court of Appeals (R. 47) is reported at 229 F. (2d) 220.

JURISDICTION.

The jurisdiction of this Court has been invoked under the Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U. S. C., section 1254 (1), by petition for writ of certiorari alleging

a conflict between the decision of the Court of Appeals in this case and the decisions of other Courts of Appeals on the same matter. The judgment of the Court of Appeals was entered January 19, 1956. (R. 61.) An order denying petitioner's petition for rehearing was entered February 16, 1956. (R. 61.) The petition for a writ of certiorari was filed April 14, 1956. The order granting certiorari was entered June 4, 1956, by this Court. (R. 62.)

STATUTES INVOLVED.

The statutes involved are sections 23 (s) and 122 of the Internal Revenue Code of 1939, as amended and in force at the relevant time. 26 U. S. C. (1952 ed.), sec. 23, 122. The pertinent text of these statutes is set forth in the Appendix, infra, pp. 37-~~41~~ 39.

QUESTION PRESENTED.

The question presented is whether the petitioner, as the surviving corporation in a statutory merger of seventeen (17) corporations under the laws of Missouri and Illinois, in computing its net income for its first taxable period commencing after the date of the merger, is entitled to carry over and deduct net operating losses sustained by three of the merged corporations.

STATEMENT OF THE CASE.

This case is here on certiorari to review the judgment of the Court of Appeals affirming a District Court judgment dismissing petitioner's suit for refund of federal income tax for its taxable year ended July 31, 1950. After elimination of two minor issues at the appellate level, the amount involved is approximately $12,000, plus statutory interest from the date of the disputed overpayment.

Petitioner is a Missouri corporation having its principal office in St. Louis, Missouri (R. 13). It was incorporated January 2, 1946, under the name "Libson Shops Management Corporation" (R. 14). Following incorporation, petitioner provided management services for sixteen other corporations, each of which was incorporated at the same time as petitioner or a short time thereafter to engage in the business of selling women's wearing apparel (R. 14). Of the sixteen sales corporations, twelve were incorporated in Missouri and four were incorporated in Illinois (R. 14).

Prior to August 1, 1949, petitioner's issued and outstanding capital stock consisted of 470 shares of the par value of $100 each, and the issued and outstanding capital stock of each of the sixteen sales corporations consisted of 20 shares of $100 par value each (R. 19-21). Prior to August 1, 1949, all of the stock of the petitioner and of each except one of the sixteen sales corporations was held by eight individuals, six of whom held 14.05 per cent each and two of whom held 7.85 per cent each of the stock of each of said corporations; while all of the stock of the remaining sales corporation was held by one of the other sales corporations (R. 21). Thus all of the outstanding stock of the petitioner and of each of the sixteen sales corporations was owned directly or indirectly by the same persons and among them in the same relative proportions (R. 21).

On July 28, 1949, each of the said corporations executed an Agreement for Statutory Merger (R. 15). The Agreement (R. 18-30) after recitals outlining the corporate history, capital structure and stock ownership of petitioner and of each of the other corporations (R. 19-21), designated petitioner as the surviving corporation in the merger (R. 22); provided for amendment of the petitioner's certificate of incorporation, changing petitioner's corporate

name to "Libson Shops, Inc." (R. 22); and its authorized capital from 1000 shares of $100 par value common stock and 500 shares of $100 par value preferred stock (R. 19) to 20,000 shares of one class of $10 par value each (R. 24); provided for the issuance of 16,000 shares of the new stock of the petitioner to the eight individual stockholders in exchange for their shares in each of the constituent corporations, in the same proportion among them as that in which they held stock, directly or indirectly, in each of the constituent corporations (R. 25); designated the same persons as directors of the surviving corporation as previously had been directors of petitioner and of each of the other constituent corporations (R. 21, 27); adopted as the by-laws of the surviving corporation the by-laws theretofore adopted by petitioner (R. 27); outlined further procedure for placing the Agreement into effect and fixed the effective date of the merger (R. 27); and spelled out certain effects of the merger (R. 28-29).

On August 1, 1949, the merger of the sixteen sales corporations into the petitioner was effected under and in accordance with Section 67 of "The General and Business Corporation Act of Missouri," and Sections 69 (a) and 66 of "The Business Corporation Act" of the State of Illinois (R. 15, 30-32).

At the close of their taxable periods ended July 31, 1949, three of the Libson corporations had unused net operating loss carry-overs for federal income tax purposes, resulting from net operating losses sustained by them in those or prior taxable periods (R. 16).

Petitioner, in computing net taxable income for its taxable year August 1, 1949, to July 31, 1950, deducted $22,432.76, the total of the unused net operating loss carry-overs of the three corporations at July 31, 1949, computed as follows:

Corporation	Taxable Period of Loss	Amount
Evanston Libson Shops, Inc.	Calendar year 1948	$ 8,115.11
	Jan. 1, 1949, to July 31, 1949	6,122.28
Lawrence Libson Shops, Inc.	Jan. 1, 1948, to July 31, 1948	245.03
	Fiscal year ended July 31, 1949	2,770.42
Hampton Libson Shops, Inc.	Fiscal year ended July 31, 1949	4,879.92
	Total	$22,432.76

The deduction of $22,432.76 was disallowed in full by the Commissioner of Internal Revenue, who, on May 21, 1953, issued a statutory notice of deficiency (R. 14). On June 6, 1953, petitioner paid to the respondent herein the amount of the deficiency plus interest (R. 14) and on August 13, 1953, filed claim for refund of that amount (R. 17, 6-11). On March 16, 1954, the Commissioner disallowed the claim (R. 18).

On April 2, 1954, petitioner filed suit in the District Court to recover the amount so claimed. On April 15, 1955, the District Court entered its judgment dismissing petitioner's suit. On June 13, 1955, petitioner appealed to the Court of Appeals with the result above-stated.

SUMMARY OF ARGUMENT.

Petitioner is entitled to the carry-over under section 122 of the Internal Revenue Code of 1939 because it is the "taxpayer" with respect to the losses of each of the merged corporations. This follows from the applicable Missouri and Illinois statutes, which reflect the familiar concept of a statutory merger, under which the surviving corporation absorbs each of the others and inherits their rights and obligations. **Helvering v. Metropolitan Edison Co.**, 306 U. S. 522 (1939). Moreover, the statute, construed in the light of the original purpose of the net operating loss carry-over provisions it contains, allows the carry-over to a corporation standing in the tax shoes of the corporation having the loss. S. Rep. No. 617, 65th Cong., 3d Sess. The petitioner as the surviving corporation in a statutory merger stands in just such a position with respect to each of the merged corporations. It is a well-settled rule of federal tax cases, that the surviving corporation being primarily and not derivatively liable for the taxes of each merged corporation, it is to be treated as the same corporation for other tax purposes. **Stanton Brewery, Inc. v. Commissioner**, 176 F. (2d) 573 (2d Cir., 1949).

This construction of section 122 is consistent with Congress' historical attitude toward the tax significance of corporate reorganization, manifested most recently by section 381 of the 1954 Internal Revenue Code, which expressly allows the carry-over in a case such as this, as well as in other reorganizations. See **Koppers Company, Inc., v. United States**, 134 F. Supp. 290 (Ct. of Claims, 1955). (Whether the carry-over under the 1939 Code extends to successor corporations in tax-free reorganizations other than statutory mergers is a broader question than that here involved. There is a clear distinction between the continuity of legal incidents which is characteristic of a

statutory merger and the continuity of economic interests which may be said to be characteristic of tax-free reorganizations generally. Cf. **New Colonial Ice Co. v. Helvering**, 292 U. S. 435 [1934]. While reconsideration of the doctrine of that case may be appropriate, it is not necessary.)

All other appellate authority beginning with the **Stanton Brewery** case, decided in 1949, and continuing without deviation through a series of cases decided in the past year (**Koppers Company, Inc., v. United States**, supra; **E. & J. Gallo Winery v. Commissioner**, 227 F. [2d] 699 [9th Cir., 1955], and **Newmarket Manufacturing Co. v. United States**, 233 F. [2d] 493 [1st Cir., 1956]) supports petitioner's position and conflicts sharply with the decision from which this petition was taken. The Government itself is on record in support of the same position, having held that in cases of statutory merger tax credits of a merged corporation emerge in favor of the survivor. E. g., P. S. 62, 505 CCH Standard Federal Tax Rep., par. 6118. The Government's inconsistency is so startling that petitioner is forced to conclude either that the Government has changed its view in the course of the present litigation or that its real position today is that this case turns upon special facts which distinguish it from the others mentioned, although that position in turn is belied by the Government's petition for certiorari in **United States v. Newmarket Mfg. Co.**, No. 216 in this Court.

The Court of Appeals' opinion herein can only be explained in terms of failure to give proper consideration to the reasonable views expressed in the conflicting cases, or in terms of a mistaken notion that this case has features which set it apart from the others. The Court relies upon **New Colonial Ice Co. v. Helvering**, supra, although that case is clearly distinguishable, and it fails to give effect to **Helvering v. Metropolitan Edison Co.**, supra, although the latter in principle is controlling.

ARGUMENT.

I. THE PROBLEM IN ITS LEGISLATIVE SETTING.

A. The Statutes Involved.

The statutes involved are sections 23 (s) and 122 of the Internal Revenue Code of 1939. A brief history of their origin and amendment is contained in the Appendix, infra, pp. 37-39.

Section 23 (s) provides that in computing net income there shall be allowed "the net operating loss deduction computed under Section 122."

Section 122 consists of subsections (a) to (e); (a) defines "net operating loss" as the excess of allowable deductions over gross income, with certain qualifications. Of course, where deductions exceed gross income for a given taxable year, there is no net income subject to tax for that year, so that a "net operating loss" can have no tax significance for the year of loss. The essence of the statute, therefore, is to be found in subsections (b) and (c), which provide for determination of the amount of "carry-back" and "carry-over" and the amount of net operating loss deduction, i. e., they provide that the net operating loss for a given taxable year may be deducted (i) in computing taxable income of preceding years (a "carry-back") and (ii) to the extent not required to absorb income of the carry-back years, in computing taxable income of succeeding years (a "carry-over"). See **Reo Motors v. Commissioner**, 338 U. S. 442, 446 (1950).

Subsection (d) of 122 contains certain exceptions and limitations which are applicable in determining the loss, the carry-back or carry-over and the deduction, but none

of these is material here, and subsection (e) is not material here.

Petitioner claims a net operating loss deduction in the amount of the aggregate net operating loss carry-overs of the Evanston, Lawrence and Hampton corporations. It is not disputed that 23 (s) allows the deduction if it is properly computed under 122, or that the amount of the deduction is properly computed under 122 (c) if the petitioner is entitled to the carry-overs under 122 (b). Inasmuch as all of the losses here involved were sustained during the period covered by 122 (b) (2) (C), this is the portion of the statute which is the object of particular concern.

122 (b) (2) (C) provides in applicable part as follows:

> "If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years. . . ."

The statute furnishes "no explicit guidance for the problem at hand." **Newmarket Manufacturing Co. v. United States**, 233 F. (2d) 493, 496 (1st Cir., May 18, 1956). In this situation the Government has sought the answer in terms of a mechanical application of the term "taxpayer," contending that petitioner is not the "taxpayer" which sustained the loss. Brief for the Respondent in Opposition, p. 5. Cf. **E. & J. Gallo Winery v. Commissioner**, 227 F. (2d) 699, 704 (9th Cir., 1955), and **Newmarket Mfg. Co. v. U. S.**, supra, p. 496, where similar reasoning was noted and rejected as unsound.[1]

Petitioner on the other hand contends, first, that even adopting this literal approach it is the "taxpayer," be-

[1] Compare also the general Code definition, "'taxpayer' means any person subject to a tax . . ." I. R. C. 1939, sec. 3797 (a) (14); 26 U. S. C. (1952 ed.), sec. 3797.

cause the surviving corporation in a statutory merger includes each of the merged corporations; and, secondly, that construing the statute in the light of its purpose, petitioner is entitled to the carry-overs because, tax-wise, it stands in the same position as each of the merged corporations.

1. Petitioner includes each of the merged corporations.

The merger was accomplished under the laws of Missouri and Illinois.[2] Both provide that domestic corporations and foreign corporations may merge in accordance with a prescribed procedure, which was followed here (R. 15). The provisions dealing with the effect of merger upon the status, rights and interests of the merging corporations are identical. They are as follows:

> "(a) The several corporations parties to the plan of merger or consolidation shall be a single corporation. . . . (b) The separate existence of all corporations parties to the plan of merger or consolidation, except the surviving or new corporation, shall cease. . . . (d) Such surviving or new corporation shall thereupon and thereafter possess all the rights, privileges, immunities and franchises, as well of a public as of a private nature, of each of the merging or consolidating corporations; and all property . . . and all and every other interest, of . . . each of the corporations so merged or consolidated, shall be taken and deemed to be transferred to and vested in such single corporation without further act or deed; . . ." Missouri Act, sec. 70; Illinois Act, sec. 69.

These provisions operate to continue each of the merging corporations within the framework of one, the nom-

[2] The General and Business Corporation Act of Missouri, Laws 1943, p. 410, secs. 62, 68, 70, Mo. R. S. 1949, secs. 351.410, 440, 450; The Business Corporation Act of Illinois, secs. 61, 67, 69, 69a, Ill. R. S., c. 32, sec. 157. The pertinent text is set forth in the Appendix, infra, pp. 40-44.

inal survivor. The merging corporations "shall be" a single corporation, i. e., the several are blended into one, and it is only the "separate" existence of the others which ceases. The rights and interests are "deemed to be" transferred, i. e., they pass not by transfer, but by operation of law. **Dodier Realty and Investment Co. v. St. Louis National Baseball Club**, 238 S. W. (2d) 321 (Mo., 1951).

This construction of the Missouri and Illinois statutes is in accord with the generally recognized concept of statutory merger, as effecting the "absorption" of the merging corporations by the nominal survivor. **Fletcher, Cyc. Corp.** (Perm. Ed.), sec. 7041. The concept has been expressed in various ways.

Thus, with reference to a merger under the General Corporation law of the State of Delaware,[3] it has been said:

> ". . . the old corporations have their identity absorbed into that of the . . . one into which they were merged." **Argenbricht v. Phoenix Finance Co. of Iowa**, 21 Del. Ch. 288, 187 A. 124, 126 (1936).

Another court, interpreting the same statute, said:

> "From the moment of consolidation the 'existence of each of these corporations is to be a combined existence manifested solely through and operating in the name of the consolidated corporation.'" **Aspinook Corp. v. Commissioner**, 326 Mass. 327, 94 N. E. (2d) 366, 368 (1950).

Again, in **Stanton Brewery, Inc., v. Commissioner**, 176 F. (2d) 573 (2d Cir., 1949), the court, speaking of a merger under New York law, said:

---

[3] Now Title 8, Del. Code of 1953. Like the Missouri and the Illinois statutes, section 60 of the Delaware law involved in the *Argenbricht* case covered both consolidation and merger and provided that as a result of either "the *separate* existence . . . shall cease . . ." See Del. Code of 1953, sec. 259.

> "... we must regard the 'resulting corporation' as the union of component corporations into an all-embracing whole which absorbs the rights and privileges, as well as the obligations, of its constituents." 176 F. (2d) 575.

With reference to a merger under the Civil Code of California[4] it has been said:

> "... the separate corporate existence [of the merging corporation] suffered the fate of all merged corporations ... became a part of the muscle and blood stream of the mergee corporation. ... While the ... merger ... caused it to lose its identity as to its separate existence, yet it became an integral part [of the surviving or 'mergee' corporation]." **Mutual Building and Loan Association of Pasadena v. Wiborg**, 59 Cal. App. (2d) 325, 328, 329, 139 P. (2d) 73, 74, 75 (1943).

Or as this Court has put it:

> "... the corporate personality of the transferor is drowned in that of the transferee." **Helvering v. Metropolitan Edison Company**, 306 U. S. 522, 529.

No matter how grim the metaphor, the idea is the same: In a statutory merger the surviving corporation alone continues its nominal existence, but it includes each of the merged corporations. Therefore, the petitioner is the "taxpayer" under the statute.

2. Petitioner through the merger achieved the tax status of each of the merged corporations.

The application of the language of a revenue provision such as section 122 "is not an exercise in framing ab-

---

[4] Section 361 of the Code, in effect at the time the cited case was decided, provided that the merging corporations "shall be one corporation" and that "the separate existence of the constituent corporations shall cease, except that of the surviving corporation."

stract definitions." **Bazley v. Commissioner**, 331 U. S. 737, 741 (1947). "Legislative words are not inert, and derive vitality from the obvious purposes at which they are aimed." **Griffiths v. Commissioner**, 308 U. S. 355, 358 (1939).

The purpose of the carry-over appears from the legislative history of the first such provision in section 204 (b), Revenue Act of 1918, c. 18, 40 Stat. 1057, which finds Congress recognizing that the principle of strict annual tax accounting is at odds with the law's essential scheme of taxing net income:

> "At the present time no recognition is given to net losses; that is, if in any year the losses and expenses of a taxpayer exceed his gross income the excess (or, in other words, the net loss) cannot be carried over into the next year. For purposes of taxation the settlement must be made upon the basis of each year's business by itself. The chief merit of the present plan is its simplicity of administration. But it does not adequately recognize the exigencies of business, and, under our present high rates of taxation, may often result in grave injustice." S. Rep. No. 617, 65th Cong., 3d Sess., 1939-1 Cum. Bull. (Part 2) 121-122.

In other words, prior to the 1918 Act, if a person subject to income tax had income in excess of deductions in a given year, he was required to pay a tax, but if his deductions exceeded his income for the same year, the Government made no corresponding concession. The slate was wiped clean, the excess deductions lost all tax significance at the close of the year, and "income," the subject of tax, lost contact with economic reality.

This was the condition which the first carry-over provision was designed to remedy, and which, therefore,

should be considered in construing subsequent versions including the present statute. When section 122 (b) (2) (C) provides that loss for a given year may be considered in computing taxable income of succeeding years, it is intended to neutralize the liability for tax which would have attached had there been net income in the given year. So construing the statute, its benefits reasonably extend to one against whom such liability would have attached, and it remains only to demonstrate that petitioner, following the merger, was subject to tax for the years of loss to the same extent and in precisely the same sense as were the Evanston, Lawrence and Hampton corporations prior to the merger.

The applicable Missouri and Illinois statutes both provide that upon merger the surviving corporation "shall thenceforth be responsible and liable for all the obligations of each" of the merging corporations, and that any claim against any merging corporation may be enforced, "as if such merger . . . had not taken place. . . ." Missouri Act, section 70 (e); Illinois Act, section 69 (e).

That the obligations referred to include federal income tax liabilities of the merging corporations is clear from cases dealing with consolidations given similar effect under statutes of other states. **Oswego Falls Corporation,** 26 B. T. A. 60 (1932), aff'd, 71 F. (2d) 673 (2d Cir., 1934); **A. D. Saenger,** 38 B. T. A. 1295 (1938).[5] The cited cases hold that the emerging corporation is primarily liable as "the taxpayer" and not as a transferee (26 B. T. A. 72;

[5] The *Oswego Falls* case involved a New York statute which, as set out in the opinion of the Board of Tax Appeals, provided ". . . such new corporation shall succeed to and be held liable to pay and discharge all such debts and liabilities of each of the corporations consolidated in the same manner as if such new corporation had itself incurred the obligation or liability to pay such debt or damages . . ." 26 B. T. A. 70. The statute involved in the *Saenger* case is likewise set out in the opinion and was described by the Board as substantially the same as the New York statute. 38 B. T. A. 1301.

38 B. T. A. 1302), a rule which has been confirmed by subsequent authority. **Stanton Brewery, Inc., v. Commissioner,** supra, pp. 575, 576; **Koppers Company, Inc., v. United States,** 134 F. Supp. 290, 295 (Ct. of Claims, 1955).

This rule in turn has been applied in a line of decisions holding that for other tax purposes the successor corporation in a statutory merger or consolidation stands in the shoes of each of its predecessors. Thus, a petition for redetermination of deficiency is within the jurisdiction of the Tax Court where the deficiency is assessed against a merged or consolidated corporation and the petition is filed by the surviving or resultant corporation [**Bowman Hotel Corporation,** 24 B. T. A. 1193 (1931); **Trahern Pump Company,** 27 B. T. A. 363 (1932); **Alaska Salmon Co.,** 39 B. T. A. 455 (1939)[6]] although section 272 (a) (1) of the 1939 Code, which in principle governs the question presented in each of the cases cited, provides that if the Commissioner determines a deficiency "in the case of any taxpayer," he may send a notice thereof "to the taxpayer" and thereafter "the taxpayer" may file a petition for redetermination. I. R. C. 1939, as amended, 26 U. S. C. A. (1955), sec. 272 (a) (1).

The rationale of each of the cited cases is as stated in **Alaska Salmon:**

> "The above statutes of the States of Washington and California, as we read them, provide that in a case like this, where a Washington corporation merges into a California corporation, the effect is that the surviving California corporation becomes primarily liable for the debts of the Washington corporation. The effect is thus exactly like that under the consolidation statutes of New York considered in the **Bow-**

[6] The state statute involved in the *Bowman Hotel* case is the one quoted in note 5 above. The *Trahern Pump* case involved a consolidation of four corporations under Illinois law, here involved.

man Hotel case and under the Illinois statutes in the **Trahern Pump Co.** case. The tax liabilities of the Washington corporation became the liabilities of the California corporation, and a petition filed by the California corporation for redetermination of a deficiency determined against the Washington corporation is within our jurisdiction" 39 B. T. A. 457-458.

Such decisions cannot be dismissed summarily as involving a procedural question. The expressed reason for holding the surviving or resultant corporation to be "the taxpayer" for purposes of contesting a deficiency is that it is "the taxpayer" which would be liable if the deficiency were upheld. Exactly the same reasoning applies here, for petitioner unquestionably would have been primarily liable for any deficiencies assessed against the merged corporations for the loss years. See also **Phillips v. Howe Films Co.**, 33 F. (2d) 891 (3d Cir., 1939); **Adrian & James, Inc.**, 4 T. C. 708 (1945); **Koppers Coal Co.**, 6 T. C. 1209 (1946):

B. **Related Legislation.**

The conclusion that the loss carry-over extends to the surviving corporation in a statutory merger is consistent with Congress' historical attitude toward the tax significance of corporate reorganization.

The trend, as recently noted in **Koppers Company, Inc., v. United States**, supra, has been toward "a more liberal and realistic approach," manifested in various ways:

> ". . . The language of the carry-back and carry-over provisions have been broadened and the years available for leveling out the fluctuations in earnings have been extended. Elaborate corporate reorganization provisions have been inserted in the code liberalizing the tax free exchange provisions to allow non-

> recognition of gain or loss on more transactions and the carry-over of the basis of the old corporation's assets and generally conferring upon the new corporation the same tax status of the old corporation. . . . In tax free reorganizations, the successor corporation is entitled under section 742 to use the average base period net income of its components, with certain adjustments, in determining its excess profits credit. The changes reflect a legislative policy of having tax consequences of tax free reorganizations turn on matters of substance rather than technicality or form. . . ." 134 F. Supp. 296.

In keeping with this "legislative policy," Congress twice has adverted particularly to the problem here involved, and each time has provided that the carry-over of tax benefits is not to be lost in consequence of a corporate reorganization.

The first instance was in the enactment of a statute providing that where property of a railroad corporation is acquired by another railroad corporation in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, the successor is entitled to carry over net operating losses and unused excess profits credits of the predecessor. Act of July 15, 1947, c. 249, 61 Stat. 324, sec. 1.

The Government in a number of cases has argued inferentially from this statute that if Congress had intended a similar result with respect to reorganized corporations generally, it would have said so. But the purpose of the 1947 statute was to insure the carry-over where a new corporation was organized **as well as** where a new corporation was not organized, because **in the former case** it had been held that the successor was not entitled to the carry-overs.[7]

---

[7] See H. R. Rep. No. 624, 80th Cong., 1st Sess.

Thus enactment of the 1947 statute is not evidence that Congress regarded new general legislation necessary to cover **the case of statutory merger**, where no new corporation is involved. On the contrary, the legislative history suggests the opposite conclusion. **Stanton Brewery, Inc., v. Com.**, supra, p. 577; **Koppers Co., Inc., v. U. S.**, supra, p. 297; **E. & J. Gallo Winery v. Com.**, supra, p. 706.

Congress again focused upon the problem of carry-overs in corporate reorganizations in the Internal Revenue Code of 1954, when it provided that where all or substantially all the property of a corporation is acquired by another corporation in one of four types of tax-free reorganizations (including a statutory merger), the successor is entitled to carry over certain tax-significant items (including net operating losses) of the predecessor. I. R. C. 1954, sec. 381, 68 A. Stat. 124.

Section 381 of the 1954 Code, taken as a whole, may also be regarded as part of a "statutory scheme" which reflects Congress' continuing realistic approach to the tax consequences of corporate reorganization. **Koppers Company, Inc., v. U. S.**, supra, pp. 296-297. In addition, while the committee reports state that no inference with respect to prior law is to be drawn from the enactment of this statute,[8] the reports themselves indicate Congressional consciousness of the prior-law distinction between statutory merger and other kinds of reorganization:

> "Present practice rests on court-made law which is uncertain and frequently contradictory. Your committee agrees that whether or not the items carry over should be based upon economic realities rather than upon such artificialities as the legal form of the reorganization . . . The new rules enable the successor

[8] H. R. Rep. No. 1337, 83d Cong., 2d Sess. 41; S. Rep. No. 1662, 83d Cong., 2d Sess. 277.

corporation to step into the 'tax shoes' of its predecessor corporation without necessarily conforming to artificial legal requirements which now exist under court-made law. Tax results of liquidations or reorganizations are thereby made to depend less upon the form of the transaction than upon the economic integration of two or more separate businesses into a unified business enterprise." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 52. See also H. R. Rep. No. 1337, p. 41.

Petitioner submits that Congress thus recognized that under prior law it had been held that a carry-over is allowable in a statutory merger (**Stanton Brewery, Inc. v. Com.**, supra), and that the purpose of the new law was to insure allowance of the carry-over in other reorganizations as well.

Congress intends that successor corporations generally be enabled to "step into the 'tax shoes' " of their predecessors; the surviving corporation in a statutory merger stands in the tax shoes of each merged corporation under the law as it existed prior to enactment of the 1954 Code.

II. THE PROBLEM BEFORE THE TREASURY AND IN THE COURTS.

A. The Government's Position in Cases of Statutory Merger.

The history of the present question in the appellate courts begins with the case of **Stanton Brewery, Inc., v. Commissioner**, 11 T. C. 310 (1948), rev'd 176 F. (2d) 573 (2d Cir., 1949). On December 31, 1941, a wholly-owned subsidiary merged into its parent company under New York law. In determining its adjusted excess profits net income for 1942, the surviving corporation deducted the

merged corporation's unused excess profits credits for 1940 and 1941.

The Commissioner disallowed the deduction and the Tax Court sustained the Commissioner.

The **Stanton Brewery** case involved both section 710 (c) (3) (B), I. R. C. 1939, which is exactly parallel in terms to section 122 (b) (2) (C) here involved, and a related statute, section 742, which bears no analogy to the instant case. In tracing the background of the present litigation it should be noted that the bulk of the Tax Court's opinion in the **Stanton** case, and the only part in which it makes an independent analysis of the issues, is devoted to consideration of the arguments involving section 742. 11 T. C. 311-313. When it came to consider the argument under section 710, whether or not the surviving corporation was "the taxpayer" entitled to the carry-over under that statute, the Court held that it was not, merely citing **New Colonial Ice Co. v. Helvering**, 292 U. S. 435 (1934), which did not, however, involve a statutory merger. 11 T. C. 314.

In reversing the Tax Court, the Court of Appeals in its majority opinion, notwithstanding **New Colonial Ice**, upheld the appellant's position that the merger survivor was the "taxpayer" under section 710, and said little of the arguments involving section 742. A dissent by Judge Learned Hand, conversely, rested largely on the second statute, finding it unnecessary to discuss the "taxpayer" argument. 176 F. (2d) 578.

In this situation, the Government's subsequent policy of litigating cases of statutory merger where excess profits tax credits were in issue [e. g., **California Casket Co.**, 19 T. C. 32 (1952); **E. & J. Gallo Winery**, 12 T. C. M. 414 (1953), and **Koppers Co., Inc. v. U. S.**, supra (1955)] is not wholly inexplicable since such cases conceivably might have turned upon section 742, notwithstanding the ma-

jority in **Stanton Brewery** and entirely apart from **New Colonial Ice**. But it is not as easy to understand the Government's persistence in the present case and in other net operating loss cases [**Moldit, Inc. v. Jarecki**, 53-2 U. S. T. C., par. 9551 (D. C. Ill. N. D.), appeal dismissed pursuant to stipulation (7th Cir., July 26, 1954); **Newmarket Manufacturing Co. v. U. S.**, 130 F. Supp. 706 (D. C. Mass., 1955), rev'd, 233 F. (2d) 493 (1st Cir., 1956)], which in principle parallel **Stanton Brewery** as closely as section 122 parallels section 710 in the 1939 code.[9] The Government's avowed theory has been that these cases are controlled by **New Colonial Ice**. See, for example, Brief for Respondent in Opposition herein, page 5. But as noted above **New Colonial Ice** did not involve statutory merger, and, as developed below, is clearly distinguishable on this ground. If it were not, there would be a conflict between that case and **Stanton Brewery**, yet the Government did not request certiorari in **Stanton Brewery**.

The truth is that the Government until very recently understood and agreed that in cases of statutory merger (and in at least one particular more generally[10]) questions of succession of tax attributes of the predecessor corporations are not governed by **New Colonial Ice**.

Thus, in 1950, the Commissioner ruled that contributions by a predecessor company to fund past service credits under a pension plan were deductible by the suc-

---

[9] It is possible that the Government finds a basis for distinguishing *Moldit* and *Newmarket* from *Stanton Brewery* in that the former involved carry-backs as opposed to carry-overs. See Brief for Resp. in Opposition herein, p. 9, note 2. The Tax Court has made such a distinction. *Standard Paving Co. v. Commissioner*, 13 T. C. 425, 447 (1949).

[10] See Mim. 5957, 1945 Cum. Bull. 181, 187, holding that certificates of necessity and attendant accelerated amortization generally pass to the transferee in a non-taxable reorganization under section 112 (b) of the 1939 Code.

cessor company which took over all the assets and liabilities of the predecessor pursuant to a statutory merger. The ruling states:

> ". . . the problem involved is one to be resolved in accordance with the line of distinction to be drawn between **New Colonial Ice Company, Inc., v. Helvering** . . . and **Helvering v. Metropolitan Edison Company** . . . . In **New Colonial Ice Company, Inc., v. Helvering**, supra, a new corporation was denied a deduction in respect of net operating losses previously sustained by another corporation the assets of which had been acquired, subject to liabilities, for stock of the successor, the old corporation being subsequently dissolved. In **Helvering v. Metropolitan Edison Company**, following mergers consummated pursuant to state law and in connection with which a parent corporation acquired the assets, subject to liabilities, of its subsidiaries the parent was allowed to deduct unamortized discount and expense on bonds issued by the subsidiaries prior to the mergers.
>
> "Accordingly, since the N Company acquired the assets of the M Company pursuant to a statutory merger which **by operation of law effected a fusion of the assets and liabilities** of the respective companies it is entitled to deductions in succeeding years, commencing with 1950, with respect to the balance of $350,000, **to the same extent as the M Company would have been entitled had it continued in business.**" P. S. 62, C. C. H., Standard Fed. Tax. Rep. 1950, Vol. 5, par. 6118. (Emphasis supplied.)[11]

Again, in 1951, the Government in opposing certiorari in a loss carry-back case said that:

---

[11] The decisions in the *New Colonial Ice* and *Metropolitan Edison* cases are discussed infra, pp. 30-32.

28-33

> "The assertion of conflict with **Stanton Brewery** . . . is not well founded. That decision was based squarely on the premise that the resulting corporation in a merger is the same taxpayer as the component corporation. Here there was no merger . . ." Brief for the Respondent in Opposition, p. 15, **Standard Paving Co. v. Commissioner,** 342 U. S. 860 (1951).

This is of course consistent with the Government's failure to assert conflict between **Stanton Brewery** and **New Colonial Ice.**

In keeping with the same position, in 1952, the Commissioner appears to have conceded the very issue here involved, that a surviving corporation is entitled under the 1939 Code to a net operating loss carry-over for a loss sustained by a merged corporation. **Morrisdale Coal Mining Co.,** 19 T. C. 208, 210 (1952).

What, then, is the explanation for the origin of the present controversy, since this is a case of statutory merger; and as such by the Government's own admission governed by **Metropolitan Edison** rather than by **New Colonial Ice?** Petitioner suggests that the answer is to be found in the Government's brief in **Koppers Company, Inc. v. United States,** supra, which describes an earlier "established policy" expressed in "unpublished rulings" that

> "except in instances where the merger or consolidation is brought about for the purpose of tax avoidance the corporation surviving a statutory merger or consolidation will be permitted to carry over a net operating loss of a component in that merger **to the extent that the absorbed corporation would have been able to carry over that loss had it continued its separate existence** . . ." Brief for the United States, pp. 20-21.

The brief at p. 21 goes on to indicate that this policy was not abandoned until after the commencement of the present controversy.

At no stage of this case has the Government questioned the motivation for the merger, but it has emphasized the fact that the locations formerly occupied by the Evanston, Lawrence and Hampton corporations were operated unprofitably in the year after the merger, together with the fact that the losses of several businesses are involved, as a basis for denying conflict between the decision here and those in **Stanton Brewery** and **Gallo Winery**. Brief for Resp. in Opposition, pp. 6-9.

Therefore, it appears that unless the Government's position has changed in the course of litigation, the only real dispute between the Government and the petitioner is whether these special facts justify departure from the rule of the cited cases, and certiorari having been granted by this Court, the sole basis for the Government's position has already been removed.

Even if the granting of the writ herein were not to be given this effect, the Government's contention that this case is distinguishable from **Stanton Brewery** has become untenable by virtue of the Government's recent application for certiorari in **United States v. Newmarket Mfg. Co.**, No. 216, filed June 28, 1956. If there be conflict between the present case and **Newmarket**, which like **Stanton Brewery** involves the merger of a single operating company and its parent, then the grounds on which the Government would distinguish the present case and **Stanton Brewery** are obviously unsound. The Government evidently is aware of its dilemma, for in asking for certiorari in the **Newmarket** case, it alleges not conflict but similarity between that case and this one, and makes the curious request that disposition of its petition be held in abeyance until the Court's decision herein. Petition, p. 5.

B. The Recent Cases.

The Court of Claims and two Courts of Appeals in a series of recent cases above cited have followed **Stanton Brewery** in upholding the right of surviving corporations in statutory mergers to net operating loss or excess profits credit carry-overs and carry-backs. **Koppers Company, Inc. v. U. S.**, 134 F. Supp. 290 (Ct. of Claims, Oct. 4, 1955); **E. & J. Gallo Winery v. Commissioner**, 227 F. (2d) 699 (9th Cir., Nov. 11, 1955), reversing the Tax Court, 12 T. C. M. 414 (1953); **Newmarket Manufacturing Co. v. U. S.**, 233 F. (2d) 493 (1st Cir., May 18, 1956), reversing 130 F. Supp. 706 (D. C. Mass., 1955).

In the **Koppers Company** case, a parent Massachusetts trust, a subsidiary Massachusetts trust and two subsidiary Delaware corporations were merged under the laws of Massachusetts and Delaware into Koppers Company, Inc., a newly-organized Delaware corporation. The Court of Claims held that the surviving corporation was entitled under section 710 (c) (3) (A), I. R. C. 1939 (considered both independently and in conjunction with sections 740 and 742), to carry back and apply its unused excess profits credit for a period ended after the merger in determining consolidated excess profits tax net income of the several corporations for a period ended prior to the merger.

In the **Gallo Winery** case, it appeared that Valley Agricultural Company was incorporated in 1926 and Gallo Winery in 1942, both in California. Gallo engaged in the railroad tank car business for one year. In 1943-44 members of the Gallo family acquired a controlling interest in Valley. In 1944 Gallo amended its charter to authorize it to engage in the winery business, and acquired such a business from the Gallo family. 12 T. C. M. 414, 415.

In 1945 the two corporations merged under California statute. The Court of Appeals held that Gallo Winery,

the surviving corporation, was entitled under section 710 (c) (3) (B), I. R. C. 1939, to carry over and apply an unused excess profits credit of Valley for a period ended before the merger in determining its excess profits tax net income for a period ended after the merger.

In the **Newmarket** case, a Massachusetts corporation organized and merged into a Delaware subsidiary under the applicable statutes of Massachusetts and Delaware. The Court of Appeals held that the surviving corporation was entitled under section 122 (b) (1) (B), I. R. C. 1939, to carry back and apply its net operating loss for a period ended after the merger in determining taxable net income of the merged corporation for a period ended prior to the merger.

Petitioner considers each of these three cases, together with **Stanton Brewery, Inc. v. Com.**, supra, to be authority for its position. While all of them except **Newmarket** involve unused excess profits tax credits rather than net operating losses, it is not disputed that the applicable tax statutes, section 710 and section 122 of the 1939 Code, respectively, are substantially identical, and while the **Koppers Company** and **Newmarket** cases involve carry-backs rather than carry-overs, this merely makes them *a fortiori* authority for petitioner, because if the tax experience of the surviving corporation (the whole) may be attributed to each of the merged corporations (the parts) the converse is at least as clear.

In short, the history of the present problem before the Treasury and in the courts shows the Government's stated position in this litigation in one respect to be totally inconsistent with its very recently past position, and in the other respect to be untenable; and reveals a singular preponderance of authority in support of petitioner's position that in cases of statutory merger, pre-merger tax credits

such as those covered by section 122 of the 1939 Code emerge in favor of the surviving corporation. Three Courts of Appeal and the Court of Claims have so held; the decision from which this petition was taken stands alone on the other side. By way of explanation, it may be noted that of the three recent cases above cited, all were decided after the decision of the District Court in the present case, entered April 15, 1955; that the **Newmarket** case was decided after the decision of the Court of Appeals herein, entered January 19, 1956; that the **Koppers Company** and **Gallo Winery** cases were not decided in time for petitioner to argue them in its brief filed August 30, 1955, in the Court of Appeals, and that the latter decision came too late for it to be included in oral argument presented November 17, 1955, although the **Koppers Company** case was mentioned in oral argument and **Gallo Winery** was called to the Court's attention prior to its decision. The petition for rehearing herein was prompted by the fact that the Court of Appeals' opinion makes no mention of the **Koppers Company** case and shrugs off **Gallo Winery** as all one with **Stanton Brewery** (R. 47, 57).

III. THE COURT OF APPEALS' OPINION.

The Court of Appeals at the outset seeks to place petitioner under an argumental handicap, citing the proposition that tax deductions being a matter of "legislative grace," the taxpayer has the burden of sustaining them (R. 50). If this means only that the taxpayer has the burden of appellate persuasion akin to the burden of trial proof, petitioner accepts it, having demonstrated that it is entitled to the carry-over under a reasonable construction of the statute. But if the "legislative grace" rule means strict construction against the taxpayer and in favor of the Government, it must be rejected as an easy generaliza-

tion which permits a court to abdicate its duty and function.[12]

As this Court has said:

> ". . . where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld. . . ." **Lewyt Corp. v. Commissioner,** 349 U. S. 237, 240 (1955).

The Court of Appeals in its opinion next relies on **New Colonial Ice Co. v. Helvering,** supra. After briefly noting the "factual difference" between that case and the present one (R. 56), the Court goes on to apply the holding and the language there to the facts here with complete disregard for vital differences.

In the **New Colonial Ice** case, a corporation engaged in the ice business was in financial difficulty. A new corporation was organized, the assets of the old corporation were transferred to the new in exchange for stock, which was distributed to stockholders of the old corporation in exchange for their stock. The corporate existence of the old corporation continued for almost two years after the transfer. The question was whether the new corporation was entitled to carry over net losses of the old corporation under Section 204 (b) of the Revenue Act of 1921, which provided:

> "If . . . any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; . . ."

292 U. S. 437.

---

[12] See E. N. Griswold, *An Argument Against the Doctrine That Deductions Should Be Narrowly Construed as a Matter of Legislative Grace,* 56 Harv. L. Rev. 1142 (1943).

The Court first considered the petitioner's position as requiring that the statute be construed to allow the carry-over to a taxpayer **other than** the one sustaining the loss. Here it invoked the "legislative grace" rule. l. c. 440. The Court then turned to the "alternative contention that, even though the section be not as broad as claimed, the deduction should be allowed, because 'for all practical purposes the new corporation was the same entity as the old one, and therefore the same taxpayer.'" l. c. 441.

The Court rejected this contention, but more important here are the Court's reasons for doing so:

> 1. This contention "is not in accord with the view in which the stockholders and creditors proceeded when the new company was brought into being. They deserted the old company and turned to the new one because they regarded it as a distinct corporate entity and therefore free from difficulties attending the old one." l. c. 441.

Contrast the present case where the petitioner as the surviving corporation in a statutory merger automatically succeeded to all the liabilities and obligations, i. e., the "difficulties," of each of the merging corporations.

> 2. ". . . we are of the opinion that in fact and in law the two corporations were not identical, but distinct. This was plainly implied in the transfer of assets and business from one to the other. That transaction was voluntary and contractual, not by operation of law." l. c. 441.

Contrast the present case where the transfer of assets and business to the petitioner as the surviving corporation in a statutory merger was unquestionably not voluntary and contractual, but by operation of law. **Helvering v. Metropolitan Edison Co.**, 306 U. S. 522, 528 (1939); **U. S. v. Seattle-First National Bank**, 321 U. S. 583, 587-588 (1944).

The petitioner in **New Colonial Ice**, in making the "same taxpayer" argument, was reduced to reliance upon continuity of business and continuity of stock ownership. l. c. 439. The Court of Appeals here cited the Supreme Court's answer, that continuity of business was not enough, l. c. 439, and that continuity of stock ownership was immaterial, l. c. 439, 442 (R. 54-55). But the Court of Appeals went astray in interpreting and applying this Court's requisites for allowance of the carry-over, "not continuity of business alone but of ownership and tax liability as well." l. c. 439.

In holding that such "continuity of business" is absent in the present case (R. 57), and again in attempting to distinguish **Stanton Brewery** as involving a "continuing enterprise" (R. 53-54), the Court of Appeals interprets these phrases not as requiring uninterrupted operation of the same business or businesses, despite a change in the form of operation (which is the way we read them), but as limiting the carry-over to a case of reorganization of a single business. It is submitted that this is to require not "continuity," but "unity" of business. There is continuity of business here; in the same sense as in the other cases.

Moreover, unlike those in **New Colonial Ice**, the facts in this case satisfy the other two conditions as well—continuity of ownership and tax liability. The Court of Appeals' only reason for denying that there is continuity of ownership, just as with continuity of business, is the presence of seventeen separate businesses (R. 56-57), whereas the matter of continuity of tax liability is ignored entirely. But again, what this Court deemed essential to continuity of ownership and of tax liability bears no relation to the number of businesses; rather, it consists in the **method of transfer** of the business:

> " . . . the matter of importance here, **as will be shown presently**, is not continuity of business alone

but of ownership and tax liability as well. Had the transfer from one company to the other been effected by an unconditional sale for cash, there would have been continuity of business, but not of ownership or tax liability." l. c. 439. (Emphasis supplied.)

The Supreme Court went on to "show" the necessity for continuity of ownership and tax liability by construing the applicable statute to limit the deduction to the taxpayer sustaining the loss. l. c. 440-441. Then, as noted, it rejected the petitioner's "same taxpayer" argument because the "transaction was voluntary and contractual, not by operation of law." l. c. 441.

The transaction in this case having been by operation of law, it follows that there was continuity of both ownership and tax liability within the meaning of the **New Colonial Ice** opinion.

The Court of Appeals, on the other hand, rejects the authority of **Helvering v. Metropolitan Edison Company**, 306 U. S. 522 (1939). That case involved two corporate reorganizations. The first consisted of a transfer of all the assets of certain subsidiaries to their parent company made in accordance with a Pennsylvania statute. The second consisted of a sale of all the assets of another subsidiary to the same parent, not made in accordance with the statute. In the first, the parent, after reorganization, redeemed bonds which the subsidiaries had issued prior to reorganization. In the second instance, the parent after reorganization redeemed bonds which the subsidiary had issued and the parent had guaranteed prior to reorganization. In both instances, the question was whether the parent could deduct bond discount and expense incident to issuance of the bonds which remained unamortized at the time of redemption.

The Supreme Court noted that:

"The petitioner concedes that if there has been a true merger or consolidation whereby the identity of the corporation issuing the bonds continues in the successor and the latter becomes liable for the debts of the former by operation of law, the successor may deduct amortization of discount and expense in respect of bonds issued by its predecessor as well as unamortized discount and expense on any of such bonds retired prior to maturity. The rule is not applicable upon a mere sale by one corporation of all its assets to another which assumes the liabilities of the former." 306 U. S. 526-527.

The Court said that whether the transfers of assets constituted mergers was a question of Pennsylvania law and that under that law the second transaction was a "de facto merger," while the first "has all the elements of a merger and comes within the principle that the corporate personality of the transferor is drowned in that of the transferee." l. c. 529; and held that the bond discount and expense were deductible in both situations.

It will be noted that the holding applies to the case where the bonds were not guaranteed by the parent as well as to the other. Cf. Opinion of Court of Appeals (R. 58).

The Court of Appeals would distinguish **Metropolitan Edison** on the ground that the item deducted was a post-merger credit of a successor corporation, as opposed to a pre-merger credit of a predecessor (R. 58). This distinction, as applied to a case of statutory merger, was considered but rejected in **Stanton Brewery, Inc., v. Com.**, supra, p. 576, and in **E. & J. Gallo Winery Com.**, supra, p. 705. This Court itself in the **New Colonial Ice** opinion indicated that both types of deduction turn upon the same principle when it cited together **Athol Mfg. Co. v. Commissioner**, 54 F. (2d) 230 (1st Cir., 1931), and **Turner-Farber-Love Co. v. Helvering**, 68 F. (2d) 416 (D. C. Cir., 1933),

the former denying loss carry over and the latter amortization of bond discount. 292 U. S. 442.

After interpreting **New Colonial Ice** to preclude the carry-over where the profits and losses of several businesses are involved, and attempting to distinguish **Stanton Brewery** on this ground, the Court of Appeals concludes that to allow the deduction in such a case would be to apply section 122 in a manner never intended by Congress (R. 60).

It is difficult to square this view of the law with such cases as **Northway Securities Company**, 23 B. T. A. 532 (1931), and **Alprosa Watch Corporation**, 11 T. C. 240 (1948), both involving separate businesses operated by the same corporation, which in each case was permitted to offset earlier-year losses of one business against later-year profits of the other. The fact that the separate businesses may have been operated by different corporations does not necessarily vary the result. There can be no question that where a corporation whose business has been profitable merges into a corporation with losses, the surviving corporation, under section 122, may carry over the losses and offset them against later profits attributable to the business formerly operated by the other corporation, since in such a case the corporation claiming the deduction under any construction of the statute would be the "taxpayer" having sustained the losses. Further evidence that the crediting of one corporation's losses against another's profits is contemplated by the 1939 Code is afforded by section 129, which provides that if any corporation acquires property of another corporation in a tax-free reorganization **for the principal purpose of evading or avoiding tax** by obtaining a deduction, **then** the deduction shall not be allowed. I. R. C. 1939 as amended, 26 U. S. C. A. (1955), sec. 129.[13]

[13] See H. R. Rep. No. 871, 78th Cong., 1st Sess. 24, 49 (1943); S. Rep. No. 627, 78th Cong., 1st Sess. 26, 58 (1943).

Therefore, the Court of Appeals' objection that the losses of one corporate business cannot be offset against the profits of another corporate business does not withstand examination.

In this connection, while the record in this case is devoid of any reference to section 129 or any other suggestion of improper tax avoidance, there are indications that the Courts below had a vague notion that there is something immoral about petitioner's position. The Court of Appeals quotes the trial court as follows:

> "'The effect of a ruling such as plaintiff seeks would be establishing a precedent susceptible of widespread abuse . . . bankrupt corporations with tax credits would find themselves the object of desirable purchase or 'merger' by or with corporations with tax liabilities, in order that after purchase the tax credits could be used to offset taxes due, just as plaintiff would do in this case. Regardless of what the motive or motives for including the corporations with tax credits in the merger, we have no doubt that use of their tax credits was one . . . .'" (R. 51).

It is submitted that in the final analysis both the District Court and the Court of Appeals may well have reached their decisions on the basis of this unfounded suspicion of tax avoidance, coupled with the effect they gave to the fact that the locations operated by the three merged corporations having losses before the merger continued to be unprofitable in the year after the merger. The Court of Appeals believed that to allow the carry-over in this situation "would mean that the merger of these corporations and the merger alone would be responsible" for the petitioner's obtaining the deduction (R. 57).

If the Court is giving credence to the trial court's suggestion that the plan of merger was adopted so that tax

credits would not be lost (cf. R. 51), it is crediting petitioner with a foresight that it must disclaim. It is, indeed, stipulated that the stores operated by the corporations which had loss carry-overs at July 31, 1949, continued to lose money in the taxable year ended July 31, 1950 (R. 17). As the merger was effected August 1, 1949, and obviously planned some time before that date, however, this fact hardly could have influenced the decision to merge.

Secondly, it is not necessarily true that, had the merger not taken place, the credits could not have been utilized by the merged corporations, as the statutory carry-over period is three years, and on the facts, the losses would have been available for carry-over by the loss corporations for from one to two years after the year ended July 31, 1950 (R. 17).

Finally, and most important, as the Court of Appeals itself recognized, this is not a "logical argument" against petitioner's position (R. 57). It is not disputed that at July 31, 1949, the Evanston, Lawrence and Hampton corporations had sustained net operating losses for years covered by the statute. This condition being satisfied, the only question under the statute is whether the petitioner is entitled to carry over these losses. Petitioner had income against which to offset the losses in the year in question. The fact that losses were attributable to particular segments of petitioner's operating assets after the merger is wholly immaterial.

CONCLUSION.

Therefore, petitioner asks that this Honorable Court reverse the judgment of the United States Court of Appeals in its Docket No. 15,397 and remand the case with instructions for further disposition consistent with such reversal (including the ultimate award to the petitioner of judgment against respondent in the amount demanded by peti-

tioner in Docket No. 6722 of the United States District Court for the Eastern District of Missouri).

Respectfully submitted,

ABRAHAM LOWENHAUPT,
HENRY C. LOWENHAUPT,
OWEN T. ARMSTRONG,
408 Olive Street,
St. Louis 2, Missouri,
Counsel for Petitioner.

Of Counsel:
LOWENHAUPT, MATTINGLY, CHASNOFF, FREEMAN & HOLLAND.

APPENDIX.

Statutes Involved.

Internal Revenue Code of 1939:

Sec. 23. **Deductions from Gross Income.**

In computing net income there shall be allowed as deductions:

* * * * * * *

(s) [as added by Section 211, Revenue Act of 1939, c. 247, 53 Stat. 862] **Net Operating Loss Deduction.**—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * * * *

(26 U. S. C., 1952 ed., sec. 23.)

Sec. 122 [as added by Section 211, Revenue Act of 1939, supra]. **Net Operating Loss Deduction.**

(a) [as amended by Section 105, Revenue Act of 1942, c. 619, 56 Stat. 798] **Definition of Net Operating Loss.**—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [as amended by Section 215, Revenue Act of 1950, c. 994, 64 Stat. 906] **Amount of Carry-Back and Carry-Over.**—

(1) **Net operating loss carry-back.**—

(A) **Loss for Taxable Year Beginning Before 1950.**—If for any taxable year beginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net oper-

ating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year * * *.

* * * * * * *

(2) **Net operating loss carry-over.**—

* * * * * * * *

(C) [as added by Section 330, Revenue Act of 1951, c. 521, 65 Stat. 452] **Loss for Taxable Year Beginning After December 31, 1947, and Before January 1, 1950.**—If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years * * *.

* * * * * * *

(c) [As amended by Sections 105 (e) (3) (B) and 153 (b) of the Revenue Act of 1942, supra, and Section 121 (g) (2) of the Revenue Act of 1950, supra] **Amount of Net Operating Loss Deduction.**—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income [computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)] exceeds, in the case of a taxpayer other than a corporation, the net income

(computed without such deduction), or, in the case of a corporation, the normal-tax net income [computed without such deduction and without the credits provided in sections 26 (b) and (i)];

* * * * * * * *

(26 U. S. C., 1952 ed., sec. 122.)

(ii) **Historical Note.**

The concept of loss carry-back and carry-over was introduced to the federal income tax by the Revenue Act of 1918, which provided for a one-year carry-back and a one-year carry-over of "net loss." Section 204 (b), Act of Feb. 24, 1919, c. 18, 40 Stat. 1057. The provision was later changed by eliminating the carry-back and by increasing the carry-over period to two years, and as such it appeared in all revenue acts prior to the Act of 1932, which reduced the carry-over period to one year. The net loss carry-over was entirely eliminated in the National Industrial Recovery Act of 1933. See H. R. Rep. No. 855, 76th Cong., 1st Sess. 9-10. A two-year carry-over (of "net operating loss") was restored by the Revenue Act of 1939, which added Sections 23 (s) and 122 to the Internal Revenue Code. Section 211, Act of June 29, 1939, c. 247, 53 Stat. 862-885.

In 1942, section 122 (b) became 122 (b) (1) and 122 (b) (2), the former making provision for a two-year carry-back and the latter continuing provision for a two-year carry-over. Section 153 (a), Act of Oct. 21, 1942, c. 619, 56 Stat. 798. The statute was further refined in 1950, when, with respect to losses thereafter sustained, the carry-back period was increased to five years. Thus both 122 (b) (1) and 122 (b) (2) were subdivided into subparagraphs (A) and (B). Section 215 (a), Act of Sept. 23, 1950, c. 994, 64 Stat. 906. In 1951 the carry-over provisions were amended to provide for a three-year carry-over of losses sustained

between 1947 and 1950. Section 330 (b), Act of Oct. 20, 1951, c. 521, 65 Stat. 452, adding 122 (b) (2) (C).

(iii) **State Statutes Governing Merger.**

Sections 62 (Part), 68 and 70, The General and Business Corporation Act of Missouri, Laws 1943, p. 410, secs. 62, 68, 70, R. S. Mo. 1949, sec. 351.410, 440 and 450.

Section 62 (Part):

"Any two or more domestic corporations formed for a purpose for which a corporation may be formed under this Act and any domestic corporation or corporations and foreign corporation or corporations formed for a purpose of which a corporation might be formed under this Act may merge into one of such corporations. . . ."

Section 68:

"Upon the issuance of the certificate of merger or the certificate of consolidation by the Secretary of State, the merger or consolidation shall be effected."

Section 70:

"When such merger or consolidation has been effected:

(a) The several corporations parties to the plan of merger or consolidation shall be a single corporation, which, in the case of a merger, shall be that corporation designated in the plan of merger as the surviving corporation, and, in the case of a consolidation, shall be the new corporation provided for in the plan of consolidation.

(b) The separate existence of all corporations parties to the plan of merger or consolidation, except the surviving or new corporation, shall cease.

(c) Such surviving or new corporation shall have all the rights, privileges, immunities, and powers and shall be subject to all the duties and liabilities of a corporation organized under this Act.

(d) Such surviving or new corporation shall thereupon and thereafter possess all the rights, privileges, immunities and franchises, as well of a public as of a private nature, of each of the merging or consolidating corporations; and all property, real, personal and mixed, and all debts due on whatever account, including subscriptions to shares, and all other choses in action, and all and every other interest, of or belonging to or due to each of the corporations so merged or consolidated, shall be taken and deemed to be transferred to and vested in such single corporation without further act or deed; and the title to any real estate, or any interest therein, under the laws of this State vested in any of such corporations shall not revert or be in any way impaired by reason of such merger or consolidation.

(e) Such surviving or new corporation shall thenceforth be responsible and liable for all the liabilities and obligations of each of the corporations so merged or consolidated, and any claim existing or action or proceeding pending by or against any of such corporations may be prosecuted to judgment as if such merger or consolidation had not taken place, or such surviving or new corporation may be substituted in its place. Neither the rights of creditors nor any liens upon the property of any of such corporations shall be impaired by such merger or consolidation.

(f) In the case of a merger, the articles of incorporation of the surviving corporation shall be deemed to be amended to the extent, if any, that changes in its articles are stated in the articles of merger; and, in the case of a consolidation, the statements set forth in the

articles of consolidation and which are required or permitted to be set forth in the articles of incorporation of corporations organized under this Act shall be deemed to be the articles of incorporation of the new corporation.

(g) The aggregate amount of the net assets of the merging or consolidating corporations which was available for the payment of dividends immediately prior to such merger or consolidation, to the extent that the value thereof is not transferred to stated capital by the issuance of shares or otherwise, shall continue to be available for the payment of dividends by such surviving or new corporation."

Sections 61 (Part), 67, 69 and 69a (Part), The Business Corporation Act (Illinois), Ill. R. S., c. 32, sec. 157.

Section 61 (Part):

"Any two or more corporations may merge into one of such corporations. . . ."

Section 67:

"Upon the issuance of the certificate of merger or the certificate of consolidation by the Secretary of State, the merger or consolidation shall be effected."

Section 69:

"When such merger or consolidation has been effected:

(a) The several corporations parties to the plan of merger or consolidation shall be a single corporation, which, in the case of a merger, shall be that corporation designated in the plan of merger as the surviving corporation, and, in the case of a consolidation, shall be the new corporation provided for in the plan of consolidation.

(b) The separate existence of all corporations parties to the plan of merger or consolidation, except the surviving or new corporation, shall cease.

(c) Such surviving or new corporation shall have all the rights, privileges, immunities, and powers and shall be subject to all the duties and liabilities of a corporation organized under this Act.

(d) Such surviving or new corporation shall thereupon and thereafter possess all the rights, privileges, immunities, and franchises, as well of a public as of a private nature, of each of the merging or consolidating corporations; and all property, real, personal, and mixed, and all debts due on whatever account, including subscriptions to shares, and all other choses in action, and all and every other interest, of or belonging to or due to each of the corporations so merged or consolidated, shall be taken and deemed to be transferred to and vested in such single corporation without further act or deed; and the title to any real estate, or any interest therein, vested in any of such corporations shall not revert or be in any way impaired by reason of such merger or consolidation.

(e) Such surviving or new corporation shall thenceforth be responsible and liable for all the liabilities and obligations of each of the corporations so merged or consolidated; and any claim existing or action or proceeding pending by or against any of such corporations may be prosecuted to judgment as if such merger or consolidation had not taken place, or such surviving or new corporation may be substituted in its place. Neither the rights of creditors nor any liens upon the property of any such corporations shall be impaired by such merger or consolidation.

(f) In the case of a merger, the articles of incorporation of the surviving corporation shall be deemed

to be amended to the extent, if any, that changes in its articles are stated in the articles of merger; and, in the case of a consolidation, the statements set forth in the articles of consolidation and which are required or permitted to be set forth in the articles of incorporation of corporations organized under this Act shall be deemed to be the articles of incorporation of the new corporation.

(g) The aggregate amount of the net assets of the merging or consolidating corporations which was available for the payment of dividends immediately prior to such merger or consolidation, to the extent that the value thereof is not transferred to stated capital by the issuance of shares or otherwise, shall continue to be available for the payment of dividends by such surviving or new corporations."

Section 69a (Part):

"One or more foreign corporations and one or more domestic corporations may be merged or consolidated . . . ."

"The effect of such merger or consolidation shall be the same as in the case of the merger or consolidation of domestic corporations, except, if the surviving or new corporation is to be governed by the laws of any state other than this State, to the extent that the laws of such other state shall otherwise provide."